

NBU action

Intervention supports banks, UAH/USD rate

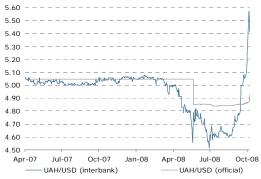
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UAH/USD exchange rate



Source: Bloomberg

- The NBU, according to press reports today, has provided assistance to 23 domestic banks, totaling UAH 3.2 bin
- The NBU conditioned assistance to banks on them lowering their UAH quotations. As of 14:00 today, the UAH/USD rate recovered to UAH/USD 5.42
- The NBU has sufficient resources at its disposal to promote stability; its gold & currency reserves were USD 37.5 bln (equal to 27% of total banking assets) as of end-September
- The future of the UAH/USD rate depends on the NBU's intervention policy

Aid provided to shore up Ukrainian banks

As expected by the banking community, the National Bank of Ukraine intervened to support the domestic system's stability. Ekonomicheskie Izvestia reported today that 23 Ukrainian banks, other than Prominvestbank, confirmed receiving support from the NBU to date, totaling over UAH 3.2 bln (USD 590 mln), including UAH 1.5 bln (USD 277 mln) to Bank Nadra, the country's #7 bank by assets.

The major liquidity concern for Ukrainian banks is the settlement of short-term foreign debt obligations. In 4Q08, Ukrainian banks are scheduled to repay about USD 1.1 bln. We estimate that only half of banks were able to refinance this debt, meaning up to an additional USD 500 mln in financing could be needed.

Last week, the NBU offered a record high loan of UAH 5 bln (USD 923 mln) to Prominvestbank, Ukraine's #6 lender, and yesterday installed a temporary head of the bank, in addition to imposing a six-month ban on the early withdrawal of term deposits.

NBU supports the UAH/USD rate

Importantly, according to Ekonomicheskie Izvestia, the NBU required banks that obtain financing from it to lower their hryvnya quotations. As an apparent result, the UAH/USD rate recovered to 5.42 as of 14:00 today.

Yesterday, after the rate reached a sky-high 5.70, the NBU took action, selling USD 200 mln for UAH 5.00 on the interbank market, which helped to depress the rate 3.6% by close. According to newspaper Kommersant, by the end of the day yesterday, the central bank had only satisfied 45-50% of banks' USD calls.

The Ukrainian hryvnya depreciated 6.7% against the US dollar from October 1 to 9. The drivers of the spike were overwhelming demand for the greenback from foreign investors and domestic households gripped by fears of further depreciation. In addition, due to the dramatic fall in steel prices, the dollar inflow from Ukrainian exporters has declined.

NBU Head Volodymyr Stelmakh stated yesterday that even in the context of the current financial situation, the UAH/USD rate should be in the range of 4.80-5.00.

Official exchange rate band widens to 4.95±8%

On October 7, the NBU decided to expand the official UAH/USD band for the rest of 2008 from $4.85\pm4\%$ to $4.95\pm8\%$. The central bank also raised the official rate to UAH/USD 4.9265 (as of today) – a remarkable step given that the rate had been set within 4.84-4.8697 since May 21 when the NBU revised its previous three-year peg, UAH/USD 5.05. The official rate is used in accounting, banking operations and taxation.



What's next?

Yesterday, Stelmakh confirmed that the NBU stands ready to support Ukrainian banks. The NBU has sufficient resources at its disposal to promote stability; its gold and currency reserves were USD 37.5 bln (equal to 27% of total banking system assets) as of end-September.

In an effort to instill confidence among average Ukrainians - Chairman of the NBU Supervisory Council Petro Poroshenko said on October 7 that the guarantee on deposit accounts in domestic banks that are members of the national Deposit Guarantee Fund would be raised to UAH 100 ths (USD $\sim\!18$ ths), roughly tenfold more than the current average deposit account in a Ukrainian bank

In addition, last week, the NBU canceled the interest rate cap on long-term borrowing by Ukrainian banks (terms of over one year) on external markets effective October 27. The upper interest rate limit on loans for over one year is currently 11%.

The further direction of the UAH/USD rate is contingent first and foremost on the NBU's intervention policy. For the last two months, the rate has been determined by the market.

If the NBU does not return to a stable intervention policy, and weakening of the hryvnya takes off again, there are important implications for the broad economy: inflationary forces could unwind again, but expansion of the C/A deficit would be reined in. Additionally, it could help export-oriented industries such as metallurgy, which controls 45% of Ukraine's exports, to boost production, stimulating industrial output and GDP.

We put our UAH/USD forecasts under review until the NBU clearly outlines its exchange rate policy.



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